

Audit Report



IMPLEMENTATION OF MOST EFFICIENT ORGANIZATION FOR
THE DEFENSE FINANCE AND ACCOUNTING SERVICE
COMMISSARY VENDOR PAYMENT FUNCTION

Report No. D-2001-023

December 20, 2000

Office of the Inspector General
Department of Defense

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Acronyms

CY	Calendar Year
DeCA	Defense Commissary Agency
DFAS	Defense Finance and Accounting Service
DFAS-CO	Defense Finance and Accounting Service, Columbus
FTE	Full-Time Equivalent
MEO	Most Efficient Organization
OMB	Office of Management and Budget



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December 20, 2000

MEMORANDUM FOR DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE

SUBJECT: Audit Report on Implementation of Most Efficient Organization for the
Defense Finance and Accounting Service Commissary Vendor Payment
Function (Report No. D-2001-023)

We are providing this report for your information and use. This report is the sixth in a series on Defense agencies' performance of commercial activities. We conducted the audit in response to a request from the Office of Management and Budget for a review to confirm that the Defense Finance and Accounting Service properly implemented the most efficient organization for in-house performance and is performing the work in accordance with terms, quality standards, and costs specified in the performance work statement. We considered management comments on a draft of this report when preparing the final report.

The Defense Finance and Accounting Service comments conformed to the requirements of DoD Directive 7650.3; therefore, additional comments are not required.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. Garold E. Stephenson at (703) 604-9332 (DSN 664-9332) (gstephenson@dodig.osd.mil) or Mr. Benjamin A. Mehlman at (703) 604-9291 (DSN 664-9291) (bmehlman@dodig.osd.mil). See Appendix C for the report distribution. Audit team members are listed inside back cover.

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Office of the Inspector General, DoD

Report No. D-2001-023

December 20, 2000

(Project No. D2000-D000CH-0076.000)

Implementation of Most Efficient Organization for the Defense Finance and Accounting Service Commissary Vendor Payment Function

Executive Summary

This audit is part of a larger review of Defense agency commercial activities programs and Office of Management and Budget (OMB) Circular No. A-76 competitive sourcing studies. The Defense Finance and Accounting Service (DFAS) announced the competitive sourcing study of the commissary vendor payment function in November 1995 and completed a study of 165 full-time equivalent personnel in September 1997. On October 1, 1997, DFAS announced that it would implement the Government's most efficient organization (MEO) for in-house performance by April 1, 1998. The in-house MEO was 75 full-time equivalent personnel and the 5-year Government estimate to perform the function was \$12.4 million. This was about \$5 million less (29 percent) than the best value private sector bid. We subsequently reviewed documentation for the commissary vendor pay study and reported in Inspector General, DoD, Report No. 99-208, "Audit of the Defense Finance and Accounting Service Commercial Activities Program," July 8, 1999, that available documentation for the study was not adequate to verify that the management plan reasonably established the Government's ability to perform the performance work statement with the resources provided by the MEO. DFAS improved internal controls over future studies, but did not strengthen controls over implementation of the MEO for the vendor payment study. The OMB requested the post-implementation review of the MEO because of the deficiencies in the study noted in our prior report. We conducted this audit from December 1999 through June 2000.

Objectives. The overall objective was to evaluate the implementation of the competitive sourcing program for Defense agency and Defense-wide commercial activities. Specific objectives of the audit were to determine whether DFAS implemented the MEO for in-house performance in accordance with the Transition Plan, the MEO was meeting the performance work statement requirements, and the incurred costs for the MEO were consistent with the Government estimate. The audit examined the adequacy of the DFAS management control program as applicable to implementation of the MEO.

Results. DFAS did not follow procedures for implementation and monitoring the MEO for the commissary vendor payment function or a subsequent MEO deviation that reduced the authorized staffing for the function from 75 to 66 personnel. Specifically,

DFAS did not: document or track implementation and transition milestones outlined in the Management Plan, Transition Plan, and Quality Assurance Surveillance Plan; establish a methodology or document the analytical process for developing the MEO deviation or adjusting staffing, costs, and metrics; appoint a quality assurance specialist to oversee the MEO performance; analyze the impact of a doubling of the volume of invoices to process; and maintain supporting documentation or establish a methodology to reconcile MEO cost estimates to MEO actual costs. As a result, DFAS does not have reliable operating information to confirm that implementation of the MEO and the MEO deviation comply with the terms, quality standards, and costs specified in the performance work statement.

Summary of Recommendations. We recommend that the Director, Defense Finance and Accounting Service establish recordkeeping and accounting requirements for documenting that each MEO for in-house performance is implemented in accordance with the Management Plan, Transition Plan, and the Quality Assurance Surveillance Plan; and that a quality assurance surveillance monitor is appointed for each MEO. We also recommend that the Director, Defense Finance and Accounting Service adjust MEO staffing, planned costs, and quality assurance metrics, for the increased volume of payments, and verify costs for the commissary vendor payment function for FYs 1998 through 2000.

Management Comments. DFAS partially concurred with the recommendations. DFAS appointed a quality assurance evaluator on May 5, 2000, and will implement guidance in December 2000 to standardize post-implementation transition documentation requirements, MEO deviation requests, and quality assurance surveillance requirements. DFAS also stated that a second MEO deviation request was under development to adjust MEO staffing, costs, and quality assurance metrics for all previous workload changes. DFAS did not agree to verify FYs 1998 through 2000 costs for the vendor payment function, stating that sufficient documentation for MEO costs presently exists. However, DFAS stated that it would implement guidance, by December 2000, to standardize a specific cost report that separately identifies MEO operation costs. See the Finding section of the report for a discussion of management comments and the Management Comments section of the report for the complete text of comments.

Audit Response. DFAS comments were generally responsive. If the proposed DFAS cost report captures present and historical costs related to the commissary vendor payment function, we believe this will fulfill the intent of the recommendation to verify costs for the function.

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Background

As a matter of accountability, the revised Office of Management and Budget (OMB) Circular No. A-76 Supplemental Handbook requires that Federal agencies conduct post-most efficient organization (MEO) performance reviews on not less than 20 percent of all functions retained or converted to in-house performance as a result of a cost comparison. There is no requirement to review any function that is converted to contractor performance. The OMB requested the Office of the Inspector General, DoD, to perform a post-MEO performance review of the Defense Finance and Accounting Service (DFAS) commissary vendor payment because of deficiencies in the competitive sourcing study for the vendor payment function that were discussed in Inspector General, DoD, Report No. 99-208, "Audit of the Defense Finance and Accounting Service Commercial Activities Program," July 8, 1999.

OMB Circular A-76. OMB Circular A-76 and its Revised Supplemental Handbook, March 1996, establish Federal policy and guidance for determining whether commercial activities should be contracted out or performed in-house. The A-76 process consists of developing the performance work statement and the management plan, submitting formal bids, and conducting the A-76 cost comparison. The management plan describes the Government's MEO and is the basis of the Government's cost estimates. The process culminates in a cost comparison of the in-house estimate of Government performance of a commercial activity with the cost for contract performance of the commercial activity function, and a decision to perform the function with Government employees or contract for its performance. Experience has shown that public and private sector competitions for the performance of commercial activities generate savings, usually through a reduction in personnel, whether the Government or the private sector wins the competitions.

Post-MEO Performance Review. OMB Circular A-76 Revised Supplemental Handbook, requires that the post-MEO performance review examine personnel full-time-equivalents (FTEs) and grade structure, contract support, MEO workload, responsiveness, and quality of work. The review evaluates implementation and use of the MEO Quality Assurance Surveillance Plan, confirms whether the MEO has been implemented in accordance with the Transition Plan, establishes the MEO's ability to perform the services of the performance work statement, and verifies that actual costs are within the estimates contained in the in-house estimate. Adjustments may be made for formal mission or scope of work changes. The review is generally conducted following the end of the first full year of performance.

Commissary Vendor Payment Function. DFAS completed the A-76 competitive sourcing study of the commissary vendor payment function on September 30, 1997, with an announcement of the decision to perform the function in-house with an MEO of 75 FTE personnel at the DFAS, Columbus (DFAS-CO). DFAS had previously performed the commissary vendor payment function using 165 FTE personnel at Fort Lee, Virginia, and San Antonio, Texas.

DFAS received bids from three commercial sources. The Government's 5-year cost estimate to perform the function at DFAS-CO was about \$5 million less than the best value private sector bid. DFAS completed implementation of the MEO in February 1998.

DFAS commissary vendor payment MEO provides vendor payment support to the Defense Commissary Agency (DeCA), which is responsible for operating and managing approximately 300 commissaries worldwide for military personnel and their families and other authorized users. DFAS processes about 2.1 million invoices per year with a total value of about \$5 billion for goods delivered to the DeCA commissaries. About 80 percent of the invoices are electronically transmitted to DFAS-CO from the Delivery Ticket Invoice systems. The Delivery Ticket Invoice system permits the receipt documents for commissary deliveries to also serve as the invoice. The remaining 20 percent of the invoices are mailed to DFAS-CO. DFAS-CO processes the high volume of commissary vendor payments because DeCA does not use the Government purchase card for payments on commissary resale contracts and orders.

Objectives

The overall objective was to evaluate the implementation of the competitive sourcing program for Defense agency and Defense-wide commercial activities. Specific objectives of the commissary vendor payment post-MEO review were to determine whether:

- DFAS implemented the MEO for in-house performance in accordance with the Transition Plan,
- the MEO was meeting the performance work statement requirements, and
- the incurred costs for the MEO were consistent with the Government estimate.

The audit examined the adequacy of the DFAS management control program as applicable to implementation of the Defense commissary vendor pay MEO. See Appendix A for a discussion of the audit scope and methodology and a review of the management control program. See Appendix B for prior coverage.

Implementation of the Most Efficient Organization

DFAS did not properly implement and monitor the MEO for the commissary vendor payment function, or a subsequent MEO deviation that reduced authorized staffing for the function from 75 to 66 personnel. Specifically, DFAS did not:

- document or track implementation and transition milestones outlined in the Management Plan, Transition Plan, and Quality Assurance Surveillance Plan;
- establish a methodology or document the analytical process for developing the MEO deviation or adjusting staffing, planned costs, and quality assurance metrics;
- appoint a quality assurance specialist as required by the MEO Management Plan and Quality Assurance Surveillance Plan to oversee, evaluate, and monitor the MEO performance;
- analyze the impact of a doubling of the volume of invoices to process; and
- maintain supporting documentation or establish a methodology to reconcile MEO cost estimates to MEO actual costs.

These conditions occurred because DFAS-CO managers lacked experience in and guidance on implementing an MEO and monitoring MEO performance and costs. As a result, DFAS did not have reliable operating information to confirm that implementation of the MEO and the MEO deviation would achieve projected cost savings, or that DFAS was performing the work consistent with the terms, quality standards, and costs specified in the performance work statement.

Transition Plan for Most Efficient Organization

Plan Content. The commissary vendor payment Transition Plan identified 152 actions and related timelines for establishing the DFAS-CO organization to perform the commissary vendor payment function. The plan also outlined the requirements for facilities, furniture and equipment, telecommunications, workstations, systems, administration, and recruitment and training of employees to perform the function at DFAS-CO. The Transition Plan also identified actions and timelines required in closing commissary vendor payment operations at Fort Lee, Virginia, and San Antonio, Texas.

The Transition Plan required DFAS headquarters and DFAS-CO to establish a transition team to implement the MEO while simultaneously mitigating impact on

vendor payments during the consolidation effort. The Transition Plan specified that DFAS-CO would implement the transition and that DFAS headquarters officials would provide oversight. DFAS-CO officials established a working group to track transition milestones included in the management plan.

Implementation at Previous Operating Locations. The DFAS transition team did not maintain adequate documentation on the actions taken to implement the human resource actions prescribed in the Transition Plan for the closure of the vendor pay operations at Fort Lee and San Antonio, including the number of personnel subject to reduction in force procedures. According to DFAS officials, only two employees transferred to the DFAS-CO location and all other former Fort Lee and San Antonio personnel were separated or placed in other positions in accordance with reduction in force procedures. DFAS-CO staffed the MEO through transfers of personnel from other DFAS-CO functions and hiring personnel.

Implementation at DFAS-CO. Except for MEO training, the DFAS transition team did not prepare and maintain appropriate documentation on implementation of Transition Plan actions at DFAS-CO. The team prepared limited minutes of November and December 1997 meetings, but did not document actions taken to achieve and monitor the Transition Plan milestones. In addition, the transition team did not verify the required workload transfer from Fort Lee and San Antonio nor did it verify claimed MEO structure and process improvements. As a result, DFAS could not provide reliable information to verify that all performance standards and productivity levels were maintained throughout the transition phase.

MEO Deviation

Justification for Change. On August 4, 1999, DFAS-CO requested a deviation to the MEO citing significant process and system changes initiated by DeCA headquarters that necessitated the need to deviate from the original MEO. The request stated that automation, increased complexity of tasks, increased DeCA inquiries, modifications and elimination of tasks, and increased travel to provide customer support contributed to the need for an MEO deviation. DFAS-CO requested a reduction of the total MEO FTE structure from 75 to 66, with estimated annual labor savings of \$158,000. On August 11, 1999, DFAS headquarters approved a DFAS-CO request to deviate from the original MEO performance work statement and MEO structure, including personnel positions and position descriptions.

Supporting Documentation for Changes. The OMB Circular No. A-76 Supplemental Handbook requires that the results of a management study must be documented to show the development and extent of the analytical process for changes made to the MEO. The MEO deviation affected 20 of the original 75 FTE positions, 8 positions were upgraded, 12 positions were eliminated, and 3 new positions were added. However, available documentation was not adequate to verify that the deviation plan reasonably established the Government's ability to perform the performance work statement. DFAS-CO did not establish a

methodology or document the analytical process used to justify the changes to the MEO structure and the performance work statement. DFAS had no policies on maintaining historical files of source documentation for the development of an MEO deviation. We believe that the Director, DFAS should establish policies and procedures for maintaining documentation on changes that occur to the MEO.

Quality Assurance Surveillance

Performance of Quality Assurance Surveillance. Quality assurance surveillance includes methods by which the Government will evaluate in-house or contractor performance to ensure that the standards of the performance work statement are met within the contract or in-house cost estimate. The OMB Circular No. A-76 Supplemental Handbook states that the quality assurance surveillance plan will identify evaluation methods to measure requirements including detailed indicators for measuring work performance. The handbook also requires specific reports of the work measurement. The management plan and quality assurance surveillance plan for the commissary vendor payment function provided that a DFAS-CO representative would serve as a quality assurance specialist. The specialist was responsible for monitoring, assessing, recording, and reporting on the technical performance of the MEO on a day-to-day basis. However, DFAS-CO could not provide any documentation of quality assurance performance evaluations of the MEO because DFAS-CO had not assigned a quality assurance monitor to oversee the commissary vendor payment MEO performance. The DFAS-CO management stated that they were unaware of the requirement to designate someone as a quality assurance specialist to oversee and monitor the performance of the commissary vendor payment function, but that other management controls provided both DFAS-CO and DeCA managers with ongoing commissary vendor payment performance information. On May 5, 2000, DFAS-CO took corrective action and appointed a quality assurance specialist for the commissary vendor payment function.

Performance of Quality Assurance Monitors on MEOs for Other DFAS-CO Functions. DFAS-CO also had not assigned a quality assurance surveillance monitor for two other DFAS-CO MEOs from OMB Circular A-76 cost comparison studies (the DFAS facilities, logistics and administration function and the commissary accounting function). DFAS-CO implemented the facilities, logistics and administration function MEO in October 1997 and the commissary accounting function MEO in September 1999. On May 5, 2000, DFAS-CO appointed quality assurance surveillance monitors for those functions.

Compliance with the Quality Assurance Surveillance Plan. The quality assurance surveillance plan contained the following three primary performance requirements:

-
- the amount of interest paid on vendor billings,
 - the amount of discounts lost to vendors, and
 - customer (DeCA and DeCA vendors) satisfaction.

DFAS-CO did not comply with the first two requirements during much of the time following implementation of the MEO, but stated DeCA delays in submitting the invoices contributed to the poor performance. DFAS-CO had not surveyed either DeCA or commissary vendors to determine satisfaction with its services.

Interest Paid On Vendor Billings. DFAS-CO monthly performance deviated from acceptable limits identified in the plan even though overall MEO performance improved. The quality assurance surveillance plan included two measures for interest paid on vendor billings. The first performance measure requires that the number of invoices with interest due should not exceed one half of one percent (.5 percent) of the total monthly invoices. During CY 1998, CY 1999, and the first 4 months of CY 2000, the actual monthly invoice defect rates were 1.7 percent, 1.2 percent, and 1.2 percent respectively. Although the figures were more than the measurement standard, DFAS-CO demonstrated improvement from the initial implementation of the MEO. The second performance measure requires that monthly interest charges because of late payments made by the MEO should not exceed \$1,700 per month in interest expense. During CY 1998, monthly interest ranged from \$27,856 to \$56,067 and averaged \$41,903 per month. For 1999, monthly interest payments ranged from \$20,288 to \$41,059, and averaged \$27,228 per month. For the first 4 months of CY 2000, monthly interest payments ranged from \$16,742 to \$27,398, and averaged \$23,031 per month. Although the monthly interest payments exceeded the limit for the entire period, the amount of monthly interest payments consistently improved.

Amount of Discounts Lost to Vendors. DFAS-CO performance for the amount of discounts lost to vendors fluctuated significantly from month to month and has declined in CYs 1999 and 2000. The quality assurance plan provides that monthly vendor discount losses should not exceed one percent of the total discounts offered. During CYs 1998 and 1999, actual monthly discount losses exceeded the percentage limit for 8 of the 12 months for both years. For the first 4 months of CY 2000, monthly discount losses exceeded the percentage limit for all months. Average monthly discount losses were 1.5 percent for 1998, 2.2 percent for 1999, and 3.4 percent for the first 4 months of 2000. The quality assurance plan also provides that monthly discount losses should not exceed \$9,000 per month regardless of the percentage limit. Actual monthly discount losses exceeded the \$9,000 per month limit for 8 months during CY 1998. The lost discounts ranged from \$3,889 to \$90,527, and averaged \$17,118 a month. DFAS improved performance on lost discounts during CY 1999 with 4 months over the limit with monthly performance ranging from \$1,371 to \$42,000 and averaging \$10,962 a month. For the first 4 months of CY 2000, monthly discount losses exceeded the limit all 4 months and ranged from \$14,551 to \$21,376 and averaged \$16,421 per month.

Responsibility for Invoice Performance. DFAS-CO officials stated that control over the outcome of performance measures was a shared responsibility between DFAS-CO and DeCA, and that the commissary vendor payment MEO had no control over the inaccurate or delayed delivery ticket invoices entered by DeCA locations. DFAS-CO officials also stated that invoice volume averaged more than 170,000 invoices a month. This amount was twice the predicted volume of 85,000 invoices per month, outlined in the Quality Assurance Surveillance Plan, at the time of the competitive sourcing study. Thus, DFAS-CO officials believed that the MEO was not solely to blame for the poor performance on interest paid and discounts lost metrics. We believe that since the volume of invoices paid has doubled, DFAS should adjust staffing, planned costs, and quality assurance metrics. If a contractor was performing tasks and the volume of the work increased, it would necessitate an increase in contract scope and dollar value, and revised metrics.

Customer Satisfaction. DFAS-CO made no attempt to measure DeCA or DeCA vendor satisfaction as required by the quality assurance surveillance plan. In order to gauge customer satisfaction, we judgmentally selected from a list of 3,180 commissary vendors provided by DFAS-CO and queried 15 vendors with large dollar amount transactions. We asked the vendors to rate DFAS-CO as good, fair, and poor in the following areas.

- Did DFAS-CO pay your invoices by the due date?
- Did DFAS-CO pay the correct amount on your invoices, including any discounts taken or payable?
- If you had a complaint or a problem with an invoice, did DFAS-CO handle the complaint or problem appropriately and in a timely fashion?

Vendor Responses. Eleven of the 15 vendors provided responses to the survey. All of the vendors stated that their invoices were generally paid on time and the correct amount was paid, and all but 3 of the 11 vendors stated they had no problems with handling complaints or problems by DFAS-CO regarding their invoice payments. For the three negative responses, vendors stated that the problem was caused by the length of time (ranging from 1 to 6 months) to resolve discrepancies with invoices. One vendor stated the MEO customer complaint section was nonresponsive to some payment problems. Eight of the 11 responding vendors rated DFAS MEO overall satisfaction as good, while 2 rated satisfaction as fair, and 1 as poor.

DeCA Satisfaction. DeCA managers reported general satisfaction with the performance of the DFAS commissary vendor payment MEO. DeCA managers stated that they monitored MEO performance through review of monthly accounting and performance status reports and worked with DFAS-CO personnel to resolve invoice payment problems. DeCA managers did not believe that any uncorrected problems existed with the commissary vendor payment MEO.

MEO Costs

Operating Costs. The commissary vendor payment function total FY 1999 operating costs were \$2.828 million, which was \$194,000 or about 7.3 percent over the total Government in-house estimate of \$2.634 million. The following table provides a summary of the estimated FYs 1999 and 2000 costs and the FY 1999 actual costs to perform the function.

Defense Finance and Accounting Service Defense Commissary Vendor Payment Government Costs (in thousands)			
<u>Cost Category</u>	<u>Estimate FY 1999¹</u>	<u>Actual FY 1999</u>	<u>Estimate FY 2000¹</u>
Personnel costs	\$2,277	\$2,243	\$2,299
Material and supply costs	10	20	10
Other specifically attributable costs ²	74	333 ³	67
Overhead ⁴	273	232	276
Total	\$2,634	\$2,828	\$2,652

¹DFAS cost estimates were based on an MEO strength level of 75.4 FTEs.
²Other specifically attributable costs consisted of property insurance, minor items, and equipment purchases.
³IG computed actual cost.
⁴Estimated overhead costs for FYs 1999 and 2000 calculated at 12 percent of estimated personnel costs in accordance with the OMB Circular A-76 Supplemental Handbook. FY 1999 actual costs calculated by DFAS at 10.36 percent of actual personnel costs.

Personnel Costs. The actual FY 1999 FTE personnel for the commissary vendor payment function fluctuated between 72 and 63 with an average of 69.08 FTE. DFAS-CO officials stated that many employees performing the commissary vendor pay function were paid at the step 10 level of their grade while the COMPARE program used to generate the MEO in-house cost estimate for the OMB Circular A-76 cost comparison calculated labor costs using the step 5 pay level for each grade. A DFAS-CO official later stated that actual personnel costs might have included costs generated from non-MEO personnel cost codes. DFAS-CO could not provide documentation to substantiate which (if any) cost codes were used to create the FY 1999 actual costs were erroneously included.

Material Costs. DFAS-CO reported that actual material costs for FY 1999 were \$20,200, about \$10,000 above the MEO cost estimate. However, DFAS-CO officials provided documentation that showed material and supply purchases

totaled \$18,197, about \$8,000 above the MEO estimate. The DFAS-CO officials could not explain the differences between the reported costs and the documented purchases.

Overhead Costs. DFAS-CO reported that actual FY 1999 overhead costs totaled \$232,000. DFAS-CO officials later stated that the "actual" amount was, in fact, an estimate based on 10.36 percent of the FY 1999 basic payroll account and that actual overhead costs attributable to the MEO were not identified. DFAS could not show that the 10.36 percent factor accurately represented actual overhead costs more than the 12 percent factor specified by the OMB Circular No. A-76 Supplemental Handbook.

Other Specifically Attributable Costs. The MEO cost estimate consists of insurance costs, minor items, facilities and other equipment costs. The actual costs in this category included \$550,300 for locally purchased equipment allocated to the vendor payment function. DFAS-CO officials stated that the equipment costs should be excluded from the comparison of actual and estimated costs because facilities and equipment were offered by DFAS to both the MEO and the contractor during the competition. However, the performance work statement indicates that the contractor would furnish desktop computer equipment and was not included as a common cost. Our analysis of the purchased equipment account determined that about 60 percent, or \$333,000 of the account balance, was for computer equipment. DFAS-CO could not provide information on how actual minor item and insurance costs were accounted for in the MEO.

FY 2000 Projected Costs. The DFAS-CO budget estimate for MEO personnel costs for FY 2000 was \$2,937,000* or \$638,000 more than the original Government in-house estimate of \$2,299,000. DFAS-CO based projected costs on 63 FTE personnel, or about 12 fewer FTEs than the original MEO. DFAS-CO budget officials stated that the commissary vendor payment function costs were overstated because cost inclusions were not part of the MEO structure. However, DFAS could not provide documentation that separately identified the MEO and non-MEO costs.

Projected Savings from MEO and MEO Deviation Implementation. DFAS-CO budget figures did not correspond to either the original or revised MEO cost estimates and DFAS-CO could not present documentation to explain the differences. As a result, DFAS did not have reliable operating information to confirm that the implementation of the MEO and MEO deviation would achieve projected cost savings. We believe DFAS should verify costs for the Defense commissary vendor payment function for FYs 1998 through 2000.

* The FY 2000 budgetary estimate for personnel costs includes actual costing data for October 1999 through March 2000.

Management Comments on the Finding and Audit Response

DFAS Comments on Transition Plan for MEO. DFAS stated that documentation is available that tracks the implementation and transition milestones. DFAS subsequently provided additional documentation regarding transition team minutes. DFAS headquarters is drafting guidance on transition phase documentation required for implementing a MEO. The guidance should be implemented in December 2000.

Audit Response. We revised the report discussion on the transition plan, based on additional transition team minutes provided by DFAS. However, we continue to believe that the documentation is insufficient to verify that transition plan milestones were adequately monitored. We consider DFAS actions to develop guidance on transition period actions responsive to the finding.

DFAS Comments on MEO Deviation. DFAS stated that no specific regulatory requirement exists for MEO deviation documentation. DFAS believed that a fully documented business case analysis was developed to support the MEO deviation. DFAS agreed that performance metrics for MEO deviation staffing and costs were not monitored through a quality assurance program but stated that the MEO deviation was tracked to determine if it met performance requirements. DFAS stated that a General Accounting Office review provided positive comments concerning the quality and content of the deviation. DFAS stated that a second MEO deviation was under development that would address all adjustments to the MEO precipitated by workload changes. DFAS headquarters is drafting guidance that will provide criteria for the documentation required for MEO deviation requests. The guidance should be implemented by December 2000.

Audit Response. The OMB Circular No. A-76 Supplemental Handbook requires documentation of management study results to show the development and extent of the analytical process for changes made to the MEO, but does not provide specific guidance on the type of MEO documentation. The initial deviation request lacked source documentation including a formal study plan identifying procedures for conducting and implementing the deviation. Thus, we could not validate the initial deviation request. The General Accounting Office Report No. NSIAD-00-107, "DoD Competitive Sourcing: Savings Are Occurring, but Actions Are Needed to Improve Accuracy of Savings Estimates," August 8, 2000, did not comment on the commissary vendor payment MEO deviation. The General Accounting Office report noted that source information was not validated.

DFAS Comments on Quality Assurance Surveillance. DFAS agreed that a quality assurance evaluator was not appointed in a timely manner. DFAS headquarters is drafting and plans to issue guidance in December 2000 that will address MEO quality assurance surveillance and supporting documentation requirements.

DFAS Comments on MEO Costs. DFAS agreed that a report identifying actual MEO costs was not available, but believed that sufficient documentation was available to determine the conformance of costs to the MEO. DFAS noted that MEO cost estimates were based on OMB Circular A-76 guidance, and as such, cannot be directly compared with actual costs when determining MEO cost performance. Also, the MEO cost estimates were derived from a variety of methodologies and factors not included in budget estimates or comparable with actual MEO costs. DFAS headquarters will issue guidance by December 2000 that will require a specifically designed cost report that identifies MEO operating costs.

Audit Response. We disagree that actual MEO costs can not be used for cost performance comparison to a MEO cost estimate. Our audit identified MEO costs from the available data that could be used for cost performance comparisons to the certified in-house cost estimate. If DFAS issues guidance requiring a report capturing present and historical verifiable MEO related costs, this will meet the intent of the finding. See Appendix A for additional comments on the Management Control Program.

Recommendations, Management Comments, and Audit Response

We recommend that the Director, Defense Finance and Accounting Service:

- 1. Establish recordkeeping and accounting requirements for documenting that each MEO for in-house performance is implemented in accordance with the Management Plan, Transition Plan, and the Quality Assurance Surveillance Plan, and that a quality assurance surveillance monitor is appointed for each MEO.**

Management Comments. DFAS partially concurred, stating that guidance will be issued by December 2000 on MEO implementation documentation and quality assurance surveillance requirements. DFAS stated that it had appointed a quality assurance evaluator on May 5, 2000.

Audit Response. DFAS comments were fully responsive to the intent of the recommendation.

- 2. Adjust MEO staffing, planned costs, and quality assurance metrics, for the increased volume of payments, and verify costs for the Defense commissary vendor payment function for FYs 1998 through 2000.**

Management Comments. DFAS partially concurred, stating that it would adjust MEO staffing, costs, and quality assurance metrics through a second MEO deviation. DFAS did not agree to verify FYs 1998 through 2000 costs for the vendor payment function, stating that sufficient documentation for

MEO costs presently exists. However, management stated in separate detailed comments that DFAS planned to issue guidance by December 2000 that would require a cost report that separately identifies the MEO operating costs.

Audit Response. If the proposed DFAS cost report captures present and historical costs related to the DeCA vendor payment MEO that can be independently verified, the management action will be fully responsive to the intent of the recommendation.

Appendix A. Audit Process

Scope and Methodology

The audit examined DFAS documents prepared between September 1997 and June 2000 to evaluate the implementation and functioning of the MEO management plan as it relates to FTEs, grade structure, MEO workload, responsiveness, and quality of work; and the implementation and use of the MEO quality assurance surveillance plan. The audit also examined actual costs incurred from October 1998 through March 2000 to determine if they varied significantly from costs in the Government estimate. We traced actual labor, material and reduction-in-force costs against the personnel, material, and other specifically attributable costs on the cost comparison form. We also surveyed DeCA and fifteen major commissary vendors on their satisfaction with the DFAS-CO commissary vendor payment function after implementation of the MEO.

DoD-Wide Corporate Level Government Performance and Results Act Coverage. In response to the Government Performance and Results Act, the Secretary of Defense annually establishes DoD-wide corporate level goals, subordinate performance goals, and performance measures. This report pertains to achievement of the following goal, subordinate performance goal, and performance measure:

FY 2001 DoD Corporate Level Goal 2: Prepare now for an uncertain future by pursuing a focused modernization effort that maintains U.S. qualitative superiority in key warfighting capabilities. Transform the force by exploiting the Revolution in Military Affairs, and reengineer the Department to achieve a 21st century infrastructure. **(01-DoD-2) FY 2001 Subordinate Performance Goal 2.3:** Streamline the DoD infrastructure by redesigning the Department's support structure and pursuing business practice reforms. **(01-DoD-2.3) FY 2001 Performance Measure 2.3.3:** Public/Private Sector Competitions.

General Accounting Office High-Risk Area. The General Accounting Office has identified several high-risk areas in the DoD. This report provides coverage of the Defense Infrastructure high-risk area.

Use of Computer-Processed Data. To achieve the audit objective, we relied on computer-processed cost accounting data on the vendor payment function calculated by the DFAS Record Analysis Decision Support System. DFAS officials stated that an initial verification review was performed in 1995 and that system reports are verified against monthly trial balances. IG, DoD, performed limited review and reliability tests of the Record Analysis Decision Support System during two previous audits performed between March 1995 and March 1996. The audits conducted test comparisons against noncomputer records. The review and tests did not identify any errors that would preclude the data from being used in their analysis. DFAS officials stated that the Record Analysis Decision Support System has not had any major changes since 1996. We did not

perform a formal validation of the Record Analysis Decision Support System and instead relied on the previously completed reviews. Nothing came to our attention in this implementation review that caused us to doubt the reliability of the computer-processed data.

Use of Technical Assistance. We received technical assistance from the Quantitative Methods Division of the Audit Follow-up and Technical Support directorate in analysis of the DFAS quality assurance surveillance plan included in the commissary vendor payments function competitive sourcing study.

Audit Type, Dates and Standards. We performed this performance audit from December 1999 through June 2000 in accordance with auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General, DoD.

Contacts During the Audit. We interviewed DFAS and DeCA personnel and commissary vendor personnel during the audit. Further details are available upon request.

Management Control Program Review

DoD Directive 5010.38, "Management Control Program," August 26, 1996, and DoD Instruction 5010.40, "Management Control Program Procedures," August 28, 1996, require DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

Scope of the Review of the Management Control Program. The management control program as it relates to the DFAS A-76 program is discussed in detail in IG, DoD, Report No. 99-208, "Defense Finance and Accounting Service Commercial Activities Program," July 8, 1999. The post-MEO implementation review is a management control procedure for the A-76 process. We reviewed the adequacy of DFAS-CO management controls over implementation of the MEO for the commissary vendor payment function. Specifically, we reviewed DFAS management controls over the transition phase and post-implementation quality assurance and cost monitoring of MEO performance associated with A-76 cost competitions.

Adequacy of Management Controls. We identified material management control weaknesses for DFAS-CO as defined by DoD Instruction 5010.40. DFAS-CO did not develop or maintain management controls over MEO implementation. DFAS-CO had not established controls to ensure that the MEO and MEO deviation were implemented in accordance with the Quality Assurance Surveillance Plan and the Transition Plan, as required by the OMB Circular A-76 Supplemental Handbook. Recommendations 1. and 2., if implemented, will improve DFAS MEO implementation and documentation retention procedures.

A copy of the report will be provided to the senior official responsible for management controls in the Office of the Under Secretary of Defense (Comptroller).

Adequacy of Management's Self-Evaluation. DFAS-CO officials did not identify implementation of the MEO for commissary vendor pay as an assessable unit and, therefore, did not identify the material management control weaknesses identified by this audit.

DFAS Comments on the Management Control Program. In management comments to a draft of this report, DFAS did not agree that a material management control weakness existed over the DFAS-CO implementation of the MEO. DFAS agreed that oversight and monitoring of MEOs is a critical area and stated that DFAS Internal Control staff is surveying all DFAS MEOs to assess implementation.

Audit Response. DFAS concurrence of the report recommendations will eliminate any future material management weakness over MEO implementation. The subsequent DFAS staff survey of MEO implementation meets the intent of management's self-evaluation.

Appendix B. Prior Coverage

General Accounting Office

General Accounting Office (GAO), Report No. NSIAD-00-107 (OSD Case No. 2020), "DoD Competitive Sourcing: Savings Are Occurring, but Actions Are Needed to Improve Accuracy of Savings Estimates," August 8, 2000

General Accounting Office (GAO), Report No. GGD-00-68 (No OSD Case No.), "Competitive Contracting: The Understandability of FAIR Act Inventories Was Limited," April 14, 2000

General Accounting Office, Report No. NSIAD-99-152 (OSD Case No. 1827), "DoD Competitive Sourcing Lessons Learned System Could Enhance A-76 Study Process," July 21, 1999

General Accounting Office, Report No. NSIAD-99-46 (OSD Case No. 1727), "DoD Competitive Sourcing: Questions About Goals, Pace, and Risks of Key Reform Initiative," February 22, 1999

General Accounting Office, Report No. NSIAD-99-44 (OSD Case No. 1725), "DoD Competitive Sourcing: Results of Recent Competitions," February 23, 1999

General Accounting Office, Report No. NSIAD-98-82 (OSD Case No. 1535), "Base Operations: DoD's Use of Single Contracts for Multiple Support Services," February 27, 1998

General Accounting Office, Report No. NSIAD-98-62 (OSD Case No. 1503), "Defense Outsourcing: Better Data Needed to Support Overhead Rates for A-76 Studies," February 27, 1998

General Accounting Office, Report No. NSIAD-98-43 (No OSD Case No.), "Financial Management: Outsourcing of Finance and Accounting Functions," October 17, 1997

General Accounting Office, Report No. NSIAD-97-86 (OSD Case No. 1301), "Base Operations: Challenges Confronting DoD as It Renews Emphasis on Outsourcing," March 11, 1997

Inspector General, DoD

Inspector General, DoD, Report No. D-2000-117, "Independent Review of the Defense Finance and Accounting Service Competitive Sourcing Study of the Depot Maintenance Accounting Function," April 28, 2000

Inspector General, DoD, Report No. 99-244, "Independent Review of the Defense Finance and Accounting Service Competitive Sourcing Study of the Transportation Accounting Function," September 1, 1999

Inspector General, DoD, Report No. 99-236, "Independent Review of the Defense Finance and Accounting Service Competitive Sourcing Study of the Defense Commissary Agency Accounting Function," August 19, 1999

Inspector General, DoD, Report No. 99-208, "Defense Finance and Accounting Service Commercial Activities Program," July 8, 1999

Inspector General, DoD, Report No. 99-078, "Outsourcing of Defense Commissary Agency Operations," February 5, 1999

Inspector General, DoD, Report No. 97-128, "Evaluation of DoD Civilian Pay Outsourcing Study," April 15, 1997

Inspector General, DoD, Report No. 97-035, "Defense Finance and Accounting Service Administration of Unit Costs," November 29, 1996

Inspector General, DoD, Report No. 96-149, "Defense Finance and Accounting Service Billing Rates," June 7, 1996

Inspector General, DoD, Report No. 95-162, "Cost Growth In Commercial Activity Contracts," March 31, 1995

Appendix C. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller/Chief Financial Officer)
Deputy Chief Financial Officer
Deputy Comptroller (Program/Budget)
Deputy Under Secretary of Defense (Installations)
Deputy Under Secretary of Defense (Acquisition Reform)

Department of the Army

Auditor General, Department of the Army

Department of the Navy

Naval Inspector General
Auditor General, Department of the Navy

Department of the Air Force

Assistant Secretary of the Air Force (Financial Management and Comptroller)
Auditor General, Department of the Air Force

Other Defense Organizations

Director, Defense Commissary Agency
Director, Defense Finance and Accounting Service
Director, Defense Finance and Accounting Service, Columbus

Non-Defense Federal Organizations and Individuals

Office of Management and Budget

Congressional Committees and Subcommittees, Chairman and Ranking Minority Member

Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
House Committee on Appropriations
House Subcommittee on Defense, Committee on Appropriations
House Committee on Armed Service
House Committee on Government Reform
House Subcommittee on Government Management, Information, and Technology, Committee on Government Reform
House Subcommittee on National Security, Veterans Affairs, and International Relations, Committee on Government Reform

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Defense Finance and Accounting Service Comments



DEFENSE FINANCE AND ACCOUNTING SERVICE

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OCT 25 2000

MEMORANDUM FOR DIRECTOR, CONTRACT MANAGEMENT, DEPARTMENT
OF DEFENSE INSPECTOR GENERAL

SUBJECT: Draft Audit Report on Implementation of the Most Efficient Organization for
the Defense Finance and Accounting Service (DFAS) Commissary Vendor
Payment Function (Project No. D2000CH-0076) (formerly Project No. OCH-
5102)

This responds to your July 24, 2000 memorandum, subject above, which
requested management comments concerning the findings and recommendations
contained in the draft audit report.

The audit findings with responses are below.

- Finding: Document or track implementation and milestones.

Response: Nonconcur. While no regulatory requirement for specific
documentation exists, documentation is available that tracks the implementation
and transition milestones.

- Finding: Establish a methodology or document the analytical process for
developing the MEO deviation or adjusting staffing, costs, and metrics.

Response: With respect to MEO deviation- Nonconcur. Although no specific
regulatory requirement exists concerning documentation of deviations, a fully
documented business case analysis was developed to support the MEO deviation.
Positive comments concerning the quality of the content and substantiation of the
deviation were received from the General Accounting Office during their recent
audit of the DeCA Vendor Pay function. With respect to the documentation to
adjust staffing, cost, and metrics – Partially Concur. Although not accomplished
through the quality assurance program, DFAS monthly performance metrics were
being monitored to determine if the MEO was meeting the necessary performance
requirements and to determine the necessity of adjustments to the MEO.
Concurrently a deviation request is under development to address all adjustments
to the MEO that were precipitated by workload changes. Completion of the
deviation request is anticipated on or about November 1, 2000.

- Finding: Appoint a quality assurance specialist to oversee the MEO performance.
Response: Concur. Management failed to appoint a quality assurance evaluator in a timely manner during the implementation process. A quality assurance evaluator was appointed in a DFAS-CO/C memorandum dated May 5, 2000 (See Attachment 1).

- Finding: Maintain supporting documentation or establish a methodology to reconcile MEO cost estimates to MEO actual costs.

Response: Nonconcur. Sufficient documentation is available to determine the conformance of costs associated with the MEO. MEO cost estimates are based on the "text book" guidance contained in OMB Circular A-76. These cost estimates contain many factors and methodologies which are not a part of any budget formulated to support the MEO, and as such cannot be directly compared with actual costs when determining the cost conformance of MEO performance.

The audit recommendations with responses are below.

- Recommendation: Establish record keeping and accounting requirements for documenting MEO implementation.

Response: Nonconcur. Sufficient MEO implementation documentation exists to assess implementation of the MEO.

- Recommendation: Appoint a quality assurance evaluator for the Vendor Payment function.

Response: Concur. As previously stated, a quality assurance evaluator was appointed by DFAS-CO/C in a memorandum dated May 5, 2000 (See Attachment 1).

- Recommendation: Adjust MEO staffing, costs, and quality assurance metrics for the increased workload volume.

Response: Concur. As previously stated, a deviation request is under development to address all adjustments to the MEO that were precipitated by workload changes. Completion of the deviation request is anticipated on or about November 1, 2000.

- Recommendation: Verify costs for the commissary vendor payment function for FY 1998 through 2000.

Response: Nonconcur. Sufficient MEO cost information is available to explain all MEO costs and any anomalies.

The audit also identified a material management control weakness in that the Columbus Site did not develop or maintain management controls over the MEO implementation, deviation

implementation, and cost monitoring. Based on the partial non-concurrence with audit findings and recommendations, I do not conclude that a material management control weakness exists in this instance. However, I do agree that oversight and monitoring of MEOs is a critical area, and I currently have my Internal Control staff surveying all MEOs to assess their implementation.

I have included for your review our detailed analysis of the draft audit report (Attachment 2). From my perspective, it appears our respective staffs still have work to do before we can truly arrive at a consensus on the audit findings and recommendations. So we can keep the process moving forward, I propose that our respective staffs meet to resolve the numerous issues and concerns presented in the analysis.

I look forward to our continued partnership as we jointly seek to ensure DFAS' customers are provided world class service.

Ms. Lois Elkin, my A-76 Program Manager, may be contacted at (703) 607-5176 or E-Mail at Lois.Elkin@dfas.mil, for further information and discussions.


Bruce M. Carles
Deputy Director

Attachment:
As stated

Attachment
2 not
included



**DEFENSE FINANCE AND ACCOUNTING SERVICE
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IN REPLY
REFER TO DFAS-CO/C

MAY 05 2000

MEMORANDUM FOR DIRECTOR, RESOURCE MANAGEMENT, DEFENSE FINANCE
AND ACCOUNTING SERVICE HEADQUARTERS
ATTN: LOIS ELKIN

SUBJECT: Appointment of Responsible Parties for Most Efficient Organizations (MEOs)

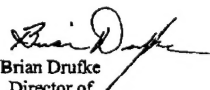
I hereby announce the following appointments. These appointments are effective immediately.

- a. Mr. John Braden, DFAS-CO/CRI, as the Columbus Centers' Contracting Officers' Representative (COR)/Quality Assurance Specialist (QAS) for A-76 studies.
- b. Ms. Susan Lockhart, DFAS-CO/TLEQ, as the QAE for the Defense Commissary Agency (DeCA) Vendor Pay MEO.
- c. Ms. Jackie Mason, DFAS-CO/TATP, as the QAE for the DeCA Accounting MEO.
- d. Ms. Philippa Houston, DFAS-CO/CIW, as the QAE for the Facilities, Logistics and Administration (FLA) MEO.

The position descriptions of these associates are being amended to reflect these duties and responsibilities. Ms. Lockhart and Ms. Mason will backup one another.

I hereby confirm the appointments of the following associates, previously assigned to duties as Supervisors of the listed MEOs.

- a. Ms. Colleen Carter, DFAS-CO/CIWP, as MEO Chief of the FLA MEO.
- b. Ms. Rebecca Beck, DFAS-CO/TLCD, as MEO Chief of the DeCA Vendor Pay MEO.
- c. Ms. Kathy Sherrill, DFAS-CO/TAE, as MEO Chief of the DeCA Accounting MEO.


Brian Druke
Director of
Support Activity Columbus

Audit Team Members

The Contract Management Directorate, Office of the Assistant Inspector General for Auditing, DoD, prepared this report. Personnel of the Office of the Inspector General, DoD, who contributed to the report, are listed below.

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INTERNET DOCUMENT INFORMATION FORM

A. Report Title: Implementation of Most Efficient Organizations for The Defense Finance and Accounting Service Commissary Vendor Payment Function

B. DATE Report Downloaded From the Internet: 01/04/01

C. Report's Point of Contact: (Name, Organization, Address, Office Symbol, & Ph #): OAIG-AUD (ATTN: AFTS Audit Suggestions)
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D. Currently Applicable Classification Level: Unclassified

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